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STATE OF IOWA
DEPARTMENT OF COMMERCE
BEFORE THE IOWA UTILITIES BOARD

IN RE:	:	**DOCKET NO. RPU-2016-_____**
LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP. D/B/A LIBERTY UTILITIES	:	

DIRECT TESTIMONY
OF
DANE A. WATSON

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Dane A. Watson. My business address is 1410 Avenue K, Suite 1105B, Plano, Texas 75074.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION?

A. I am a Partner of Alliance Consulting Group. Alliance Consulting Group provides consulting and expert services to the utility industry.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am filing Direct Testimony on behalf of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities ("Liberty Midstates" or "Company").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I hold a Bachelor of Science degree in Electrical Engineering from the University of Arkansas at Fayetteville and a Master's Degree in Business Administration from Amberton University.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. Since graduation from college in 1985, I have worked in the area of depreciation and valuation. I founded Alliance Consulting Group in 2004 and am responsible for conducting depreciation, valuation, and certain accounting-related studies for clients in various industries. My duties related to depreciation studies include the assembly and analysis of historical and simulated data, conducting field reviews, determining service life and net salvage estimates, calculating annual depreciation, presenting recommended depreciation rates to utility management for its consideration, and supporting such rates before regulatory bodies.

My prior employment from 1985 to 2004 was with Texas Utilities Electric Company and successor companies ("TXU"). During my tenure with TXU, I was responsible for, among other things, conducting valuation and depreciation studies for the domestic TXU companies. During that time, I served as Manager of Property Accounting Services and Records Management in addition to my depreciation responsibilities.

I have twice been Chair of the Edison Electric Institute ("EEI") Property Accounting and Valuation Committee and have been Chairman of EEI's Depreciation and Economic Issues Subcommittee. I am a Registered Professional Engineer in the State of Texas and a Certified Depreciation Professional. I am a Senior Member of the Institute of Electrical and Electronics Engineers ("IEEE") and served for several years as an officer of the Executive Board of the Dallas Section of IEEE as well as national and global IEEE offices. I have twice served as President of the Society of Depreciation Professionals, most recently in 2015.

Q. DO YOU HOLD ANY SPECIAL CERTIFICATION AS A DEPRECIATION EXPERT?

A. Yes. The Society of Depreciation Professionals ("SDP") has established national standards for depreciation professionals. The SDP administers an examination and has certain required qualifications to become certified in this field. I met all requirements and hold a Certified Depreciation Professional certification.

Q. HAVE YOU PREVIOUSLY TESTIFIED AT ANY REGULATORY COMMISSION?

A. Yes. I have conducted depreciation studies and filed testimony or testified on depreciation and valuation issues before more than thirty utility commissions across the United States, including FERC. A list of proceedings in which I have provided testimony is provided in Watson Exhibit DAW-1.

Q. WHAT IS THE PURPOISE OF YOUR DIRECT TESTIMONY?

A. The purpose of my Direct Testimony is to:

- discuss the Liberty MidStates – State of Iowa Asset Book Depreciation Accrual Rate Study at September 30, 2015, completed for Liberty Midstates' Iowa assets ("Iowa Asset Depreciation Study") and to support and justify the recommended depreciation rate changes for Liberty Midstates, based on the results of the Iowa Asset Depreciation Study; and,
- discuss the Liberty MidStates – Shared Services Book Depreciation Accrual Rate Study at September 30, 2015, completed for Liberty Midstates' Shared Services assets (the "Shared Services Asset Depreciation Study") and to support and justify the recommended depreciation rate changes for Liberty

Midstates' Shared Services assets as a result of the Shared Services Asset Depreciation Study.

Q. HOW IS YOUR DIRECT TESTIMONY ORGANIZED?

A. The remainder of my Direct Testimony is in three parts: Part I discusses depreciation in general and the general philosophy of depreciation analysis; Part II discusses the Iowa Asset Depreciation Study and the conclusions drawn therefrom; and Part III discusses the Shared Services Depreciation Study and conclusions drawn therefrom.

I. DEPRECIATION AND DEPRECIATION ANALYSIS

Q. WHAT IS DEPRECIATION AND WHY IS IT IMPORTANT IN THE RATEMAKING CONTEXT?

A. The term "depreciation," as I use it, is a system of accounting that distributes the cost of assets, less net salvage (if any), over the estimated useful life of the assets in a systematic and rational manner. It is a process of allocation, not valuation. Depreciation expense is systematically allocated to accounting periods over the life of the assets. The amount allocated to any one accounting period does not necessarily represent the loss or decrease in value that will occur during that particular period. Thus, depreciation is considered an expense or cost, rather than a loss or decrease in value. Liberty Midstates accrues depreciation based on the original cost of all property included in each depreciable plant account. On retirement, the full cost of depreciable property, less any net salvage amount, is charged to the depreciation reserve. It is important in the rate making context that the consumption of capital in depreciation expense be should be the matching

of expense with revenue over the life of the asset, less any gross salvage and removal cost. If capital recovery and net salvage is not allocated appropriately over the life of the assets, intergenerational inequities between customers at different points in time can be created.

Q. PLEASE DESCRIBE THE DEPRECIATION ANALYSIS PHILOSOPHY REFLECTED IN THE DEPRECIATION STUDIES YOU PERFORMED ON BEHALF OF LIBERTY MIDSTATES.

A. The objective of any sound depreciation philosophy should be the matching of expense with revenue over the life of the asset. In general, the life of the asset is determined by several factors including the rate of physical deterioration, obsolescence, weather, maintenance, or (in some cases) the economic usefulness of an entire operating unit. The function of depreciation is to recognize the cost of an asset spread over its useful life. Book depreciation techniques should not accelerate or defer the recovery of an asset in comparison to its appropriate useful life.

Q. WHAT OBJECTIVE SHOULD THE BOARD STRIVE TO ACHIEVE IN SETTING DEPRECIATION RATES?

A. The objective of computing depreciation is to ensure that all customers using the assets pay their pro rata share for the investment, including the cost of retirement. This objective is achieved by allocating the cost or depreciable base of a group of assets over the service life of those assets, on a straight-line basis, by charging a portion of the consumption of the assets to each accounting period.

Q. YOUR DEPRECIATION STUDIES ARE BASED ON DATA AS OF SEPTEMBER 30, 2015. THE TEST PERIOD PROPOSED BY LIBERTY MIDSTATES IN ITS RATE CASE IS THE CALENDAR YEAR ENDED DECEMBER 31, 2015. IS IT NECESSARY FOR DEPRECIATION STUDIES TO BE BASED UPON THE TEST YEAR BEING CONSIDERED IN THE RATE CASE? IF NOT, WHY NOT?

A. No. The depreciation study includes full years of activity based on the Company's fiscal year ending September 30. The three months that have gone by between September 30, 2015 and the test year will not materially affect the proposed depreciation rates. The proposed depreciation rates will be applied to test year end balances. In my 31 years of performing depreciation studies, it is common that depreciation studies and test years may end at different points in time.

Q. WHY HAVE YOU PERFORMED TWO DIFFERENT DEPRECIATION STUDIES?

A. The assets in the Iowa Depreciation Study and Shared Services Study are different. Assets in Iowa are used to directly provide natural gas service to its customers. Shared Services assets include customer service and billing operations. Those Shared Services functions are performed at a corporate level for Iowa, Illinois, and Missouri so each state does not have to duplicate those services. Given the different types of assets, two separate depreciation studies were performed. I have taken this approach for other companies that have utilized a Shared Services entity.

II. THE IOWA ASSET DEPRECIATION STUDY

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING DEPRECIATION RATES FOR LIBERTY MIDSTATES' IOWA ASSETS BASED ON THE RESULTS OF THE IOWA ASSET DEPRECIATION STUDY.

A. The Iowa Asset Depreciation Study and analysis fully support Liberty Midstates' proposed depreciation rates applied to September 30, 2015 depreciable plant balances for Iowa Transmission plant, Distribution plant, and General Property plant. The Iowa Asset Depreciation Study follows the regulated utility industry's long-standing precedent for Average Life Group ("ALG") straight-line depreciation. In this way, all customers are charged for their appropriate share of the capital expended for their benefit. In order to ensure intergenerational equities, the Board should adopt the life characteristics and net salvage parameters proposed in this study. The Iowa Asset Depreciation Study also incorporates updated service lives, and accounts for increased removal costs for Transmission and Distribution assets in the proposed depreciation rates. Liberty Midstates' depreciation rates should be set at the levels supported in the Iowa Asset Depreciation Study in order to allow Liberty Midstates to recover its total investment in property over the estimated remaining life of the assets.

Q. HOW IS THE IOWA ASSET DEPRECIATION STUDY USED TO DETERMINE LIBERTY MIDSTATES' DEPRECIATION EXPENSE FOR THE TEST YEAR?

A. If approved by the Board, Liberty Midstates will use the depreciation rates

determined in the Iowa Asset Depreciation Study to calculate the appropriate depreciation expense going forward for its Iowa assets. The information presented in the Depreciation Study is based on September 30, 2015 depreciable plant balances and all of the conclusions are based on those balances.

A. Summary of the Iowa Asset Depreciation Study

Q. PLEASE DESCRIBE THE IOWA ASSET DEPRECIATION STUDY.

A. I undertook a comprehensive analysis of annual depreciation for Liberty Midstates that is based on Liberty Midstates' depreciable plant in service as of September 30, 2015. The Iowa Asset Depreciation Study initially included Liberty Midstates' Iowa, Illinois, and Missouri gas assets. After the data was combined, I analyzed the property characteristics of Liberty Midstates' Transmission plant, Distribution plant, and General plant. After developing common life and net salvage parameters, I computed depreciation rates at the state level for each entity. The Iowa Asset Depreciation Study is filed with my Direct Testimony as Watson Exhibit DAW-2.

Q. WHY DID THE DATA ANALYZED IN YOUR STUDY INCLUDE IOWA, ILLINOIS AND MISSOURI TRANSACTIONS?

A. Liberty Midstates has operations in these contiguous states that are similar in operations and accounting practices. At the Company's direction, I combined the assets in these states to perform the life analysis for depreciation study. However, the depreciation rates are calculated solely on the assets for Iowa (i.e. the asset balances and depreciation reserves recorded only for Iowa property).

Q. WHAT DEPRECIATION RATES ARE YOU RECOMMENDING THAT

THE BOARD APPROVE IN THIS PROCEEDING?

A. My recommended depreciation rates for Liberty Midstates' Iowa assets are set out in Appendix B of the Iowa Asset Depreciation Study. Based on updated service life and net salvage rates for Liberty Midstates' Iowa depreciable plant in-service as of September 30, 2015, I derived the appropriate depreciation rates for Transmission plant, Distribution plant, and General plant. Below is a table summarizing the results.

TABLE 1

LIBERTY MIDSTATES' IOWA ASSETS
COMPARISON OF EXISTING VS PROPOSED DEPRECIATION RATES
AS OF SEPTEMBER 30, 2015

Function	Depreciable Plant at 9/30/15	Current Annual Expense	Proposed Annual Expense	Expense Change
Intangible	37,094.72	7,418.94	0.00	(7,418.94)
Transmission	1,419,082.81	16,217.34	26,659.58	10,442.23
Distribution	11,859,114.22	694,863.30	374,162,43	(320,700.87)
General	1,284,515.47	147,385.58	128,013.15	(19,372.44)
	14,599,807.22	865,885.17	528,835,15	(337,050.02)

Q. WHAT ACCOUNT SHOWS THE LARGEST CHANGE IN DEPRECIATION EXPENSE BETWEEN THE CURRENT AND PROPOSED ACCRUAL RATES?

A. Account 380, Distribution Services, shows the largest change in depreciation expense. The current accrual rate is 10.45% which is very high for this account. Our recommendation for Account 380 is a 33 L0 curve with negative 50 percent net salvage. For Iowa, the proposed accrual rate is 3.07%. The Company does not know the origin of the current accrual rate.

Q. WHEN DID THE LIBERTY MIDSTATES' IOWA ASSET DEPRECIATION RATES LAST CHANGE?

A. Liberty Midstates does not know when the Company's current depreciation rates were set or the underlying life and net salvage parameters. That information was not provided to Liberty Midstates when it acquired these assets from Atmos Energy in 2013. Liberty Midstates' regulatory personnel attempted to locate the information, but it was not available.

Q. HOW DID YOUR STUDY ACCOUNT FOR THE FACT THAT YOU DO NOT KNOW HOW LIBERTY MIDSTATES' CURRENT IOWA ASSET DEPRECIATION RATES WERE DEVELOPED?

A. First, I determined the appropriate lives and net salvage based on the specific historical data and statistical analysis for Liberty Midstates property to incorporate the most current life expectations for the Company. Then, I applied those life and net salvage expectations in calculating depreciation rates for Iowa Transmission and Distribution plant in order to accurately recommend the most appropriate depreciation rates for the Company's assets. Finally, Liberty Midstates proposes to implement Vintage Group Amortization for its General Plant Assets in FERC Accounts 391, 393-395, and 397-3995. The change in depreciation expense in these accounts will come from updated life and net salvage estimates for certain accounts in that group.

B. <u>Overview of Iowa Asset Depreciation Study Methodology</u>

Q. PLEASE DESCRIBE YOUR APPROACH TO THE IOWA ASSET DEPRECIATION STUDY.

A. I conducted the Iowa Asset Depreciation Study in four phases, as shown in Watson Exhibit DAW-2. The four phases are: Data Collection, Analysis, Evaluation, and Calculation. I began each of the studies by collecting the historical data to be used in the analysis. After the data had been assembled, I performed analyses to determine the life and net salvage percentage for the different property groups being studied. As part of the process for the study, I conferred with field personnel, engineers, and managers responsible for the installation, operation, and removal of the assets to gain their input into the operation, maintenance, and salvage of the assets. The information obtained from these individuals, combined with the study results, was then evaluated to determine how the results of the historical asset activity analysis, in conjunction with Liberty Midstates' expected future plans, should be applied. Using all of these resources, I then calculated the depreciation rate for each function.

Q. WHAT PROPERTY IS INCLUDED IN THE IOWA ASSET DEPRECIATION STUDY?

A. There are three distinct classes of property in this study: Transmission, Distribution, and General Property. The Transmission plant functional group consists of mains, regulators, structures, and communication equipment to transmit natural gas to the distribution system. The Distribution plant functional group consists of structures, distribution mains, measuring and regulating station equipment, services, meters, regulators, and other equipment to distribute natural gas across on the distribution system. The General Property plant functional group contains facilities associated with the overall operation of the business such

as buildings, office equipment and computers, and transportation and power operated equipment.

Q. WHAT DEPRECIATION METHODOLOGY DID YOU USE?

A. The ALG, straight-line, remaining-life depreciation system, was employed to calculate annual and accrued depreciation in the studies for all plant except assets found in FERC Accounts 391, 393-395, 397-3995. The ALG methodology is widely used across the utility industry in the United States**.**

Q. WHAT METHODOLOGY DID YOU USE TO CALCULATE DEPRECIATION FOR ASSETS IN FERC ACCOUNTS 391, 393-395 AND 397-3995?

A. As discussed later in my Direct Testimony, I propose to use the Vintage Group Methodology to determine depreciation for assets in those specified FERC accounts.

C. Transmission, Distribution, and General Property

1. Life of Transmission, Distribution, and General Assets

Q. WHAT IS THE SIGNIFICANCE OF AN ASSET'S USEFUL LIFE IN YOUR DEPRECIATION STUDY?

A. An asset's useful life is used to determine the remaining life over which the remaining cost (original cost plus or minus net salvage, minus accumulated depreciation) can be allocated to normalize the asset's cost and spread it ratably over future periods.

Q. HOW DID YOU DETERMINE THE AVERAGE SERVICE LIVES FOR EACH ACCOUNT?

A. The appropriate average service life for each account within each functional group was determined by using actuarial analysis. Graphs and tables supporting the actuarial analysis and the chosen Iowa Curves (which represent the percentage of property remaining in service at various age intervals) used to determine the average service lives for analyzed accounts are found in the Iowa Asset Depreciation Study (Watson Exhibit DAW-2) and the workpapers filed in support thereof. As detailed in the study, I relied on my judgment to incorporate any differences in the expected future life characteristics of the assets into the selection of lives. The objective of life selection is to estimate the future life characteristics of assets, not simply measure the historical life characteristics. More information can be found in the life analysis section of the Liberty Midstates Utilities Depreciation Study, Watson Exhibit DAW-2.

Q. WHAT AVERAGE SERVICES LIVES FOR TRANSMISSION, DISTRIBUTION, AND GENERAL FUNCTION ASSETS, DO YOU RECOMMEND?

A. The results are shown in Appendix C of Watson Exhibit DAW-2 as well as in Table 2 below.

TABLE 2

LIBERTY MIDSTATES UTILITIES
PROPOSED DEPRECIATION PARAMETERS
BY ACCOUNT AT SEPTEMBER 30, 2015

Acct	Description	Average Service Life	Iowa Curve
3660	T&D-Structures & Improvements	50	S3
3661	T&D-Other Structures	50	S3
3670	T&D-Mains-STL-PLST-CI-Mixed	25	SQ

3671	T&D-Mains-STL	70	R2.5
3672	T&D-Mains-PLST	N/A	N/A
3690	T&D-M&R Station Equipment	40	R2.5
3700	Communication Equipment	25	S2.5
3742	T&D-Land Rights	70	R2.5
3750	Structures and Improvements	45	R2
3760	Mains	25	SQ
3761	T&D-Mains-STL	63	R1.5
3762	T&D-Mains-PLST	65	R3
3780	Measuring & regulating stn eqt-General	40	R4
3790	Measuring & regulating stn eqt-City gate check stn	45	S2
3800	Services	33	L0
3810	Meters	10	SQ
3820	Meters Installations	27	L0.5
3830	House regulators	27	L0.5
3840	House Regulatory installations	27	L0.5
3850	Industrial measuring & regulating stn eqt	45	R3
3870	Other Equipment	10	R2
3900	General Structures & Improvement	33	L05
3901	GEN-Structure Frame	33	L05
3902	GEN-Improvements	33	L05
3903	GEN-Improvements Leased Premise	33	L05
3910	Office Furniture & Improvement	15	L3
3920	Transportation Equipment	8	L3
3921	Transportation Equip<12,000 LB	8	L3
3930	Stores Equipment	18	L3
3940	Tools, Shop, and Garage Equipment	13	L0
3950	Laboratory Equipment	15	L3
3960	Power Operated Equipment	12	L0
3961	GEN- Ditchers	12	L0
3962	GEN-Backhoes	12	L0
3963	GEN- Welders	12	L0
3970	Communications Equipment	11	L2
3971	GEN-Comm Eq. Mob Radios	11	L2
3972	GEN-Comm Eq. Fixed Radios	11	L2
3973	GEN-Comm Eq. Telemetering	11	L2
3980	Misc. Equipment	16	R1.5
3993	OTH-Oth Tang Prop - Network - H/W	7	SQ
3994	OTH-Oth Tang Prop - PC Hardware	7	SQ
3995	OTH-Oth Tang Prop - PC Software	5	SQ

2. Net Salvage Rates - Transmission, Distribution, and General Property

Q. HOW DID YOU DETERMINE THE NET SALVAGE RATES THAT YOU USED IN YOUR STUDY FOR IOWA TRANSMISSION, DISTRIBUTION, AND GENERAL PROPERTY?

A. I examined the experience realized by Liberty Midstates by observing the average net salvage rates for various bands (or combinations) of years. Using averages (such as the 5-year average band) allows the smoothing of timing differences between when retirements, removal cost, and salvage are booked and smooths the natural variations between years. By looking at successive average bands, or "rolling bands," an analyst can see trends in the data that would signal the future net salvage in the account. This examination, in combination with the feedback of Liberty Midstates' personnel related to any changes in operations or maintenance that would affect the future net salvage of Liberty Midstates, allowed for the selection of the best estimate of future net salvage for each account.

Q. IS THIS A REASONABLE METHOD FOR DETERMINING NET SALVAGE RATES?

A. Yes. This methodology is commonly employed throughout the regulated utility industry and is the method recommended in authoritative texts.

Q. WHAT ARE YOUR NET SALVAGE RECOMMENDATIONS FOR LIBERTY MIDSTATES?

A. My net salvage recommendations are found in Appendix C of Watson Exhibit DAW-2 and each account is discussed in the body of the Study. Detailed history

for each account is shown in Appendix D of Watson Exhibit DAW-2. Table 3 below shows a summary of those recommendations by account.

TABLE 3

LIBERTY MIDSTATES UTILITIES
PROPOSED DEPRECIATION PARAMETERS
BY ACCOUNT AT SEPTEMBER 30, 2015

Acct	Description	Net Salvage Percentage
3660	T&D-Structures & Improvements	-5
3661	T&D-Other Structures	-5
3670	T&D-Mains-STL-PLST-CI-Mixed	0
3671	T&D-Mains-STL	-20
3672	T&D-Mains-PLST	N/A
3690	T&D-M&R Station Equipment	-10
3700	Communication Equipment	0
3742	T&D-Land Rights	0
3750	Structures and Improvements	0
3760	Mains	0
3761	T&D-Mains-STL	-20
3762	T&D-Mains-PLST	-5
3780	Measuring & regulating stn eqt-General	-10
3790	Measuring & regulating stn eqt-City gate check stn	-10
3800	Services	-50
3810	Meters	-35
3820	Meters Installations	-35
3830	House regulators	0
3840	House Regulatory installations	0
3850	Industrial measuring & regulating stn eqt	-10
3870	Other Equipment	0
3900	General Structures & Improvement	0
3901	GEN-Structure Frame	0
3902	GEN-Improvements	0
3903	GEN-Improvements Leased Premise	0
3910	Office Furniture & Improvement	0
3920	Transportation Equipment	6
3921	Transportation Equip<12,000 LB	6
3930	Stores Equipment	0

3940	Tools, Shop, and Garage Equipment	0
3950	Laboratory Equipment	0
3960	Power Operated Equipment	10
3961	GEN- Ditchers	10
3962	GEN-Backhoes	10
3963	GEN- Welders	10
3970	Communications Equipment	0
3971	GEN-Comm Eq. Mob Radios	0
3972	GEN-Comm Eq. Fixed Radios	0
3973	GEN-Comm Eq. Telemetering	0
3980	Misc. Equipment	0
3993	OTH-Oth Tang Prop - Network - H/W	0
3994	OTH-Oth Tang Prop - PC Hardware	0
3995	OTH-Oth Tang Prop - PC Software	0

D. Reserve Reallocation

Q. WHAT IS RESERVE REALLOCATION?

A. Reserve reallocation occurs when the book reserve is respread within a functional group based on the theoretical reserve within each function.

Q. AS PART OF YOUR DEPRECIATION ANALYSIS HAVE YOU TAKEN ANY ACTION TO PROPERLY ALIGN THE COMPANY'S DEPRECIATION RESERVE WITH THE LIFE AND NET SALVAGE CHARACTERISTICS OF THE TRANSMISSION , DISTRIBUTION AND GENERAL PLANT FUNCTIONS?

A. Yes. In the process of analyzing Liberty Midstates' depreciation reserve, I observed that the depreciation reserve positions of the accounts were generally not in line with the life characteristics found in the analysis of the Company's assets. To allow the relative reserve positions of each account within a function to mirror the life characteristics of the underlying assets, I reallocated the depreciation reserves for all accounts within each function. Since the basis of the

current depreciation rates is unknown, I believe reserve reallocation is the best solution to the differences in reserve position.

Q. DOES THE REALLOCATION OF THE DEPRECIATION RESERVE CHANGE THE TOTAL RESERVE?

A. No. The depreciation reserve represents the amounts that customers have contributed to the return of the investment. The reallocation process does not change the total reserve for each function; it simply reallocates the reserve between accounts in the function.

Q. IS DEPRECIATION RESERVE REALLOCATION A SOUND DEPRECIATION PRACTICE?

A. Yes. The practice of depreciation reserve allocation is endorsed in "Public Utility Depreciation Practices", a 1968 publication of the National Association of Regulatory Utility Commissioners ("NARUC"), which explains that reallocation of the depreciation reserve is appropriate "…where the change in the view concerning the life of property is so drastic as to indicate a serious difference between the theoretical and the book reserve."[1] The 1996 edition of the NARUC publication states that "theoretical reserve studies also have been conducted for the purpose of allocating an existing reserve among operating units or accounts[2]." With respect to Liberty Midstates' Iowa assets, my depreciation study demonstrates that there have been significant changes in the life of the property

[1] Public Utility Depreciation Practices, National Association of Regulatory Utility Commissioners, 1968, page 48.

[2] Public Utility Depreciation Practices, National Association of Regulatory Utility Commissioners, 1996, page 188.

since the current accrual rates were established. These changes have created a significant difference between the theoretical and the book reserve in each functional group that make the reallocation of the depreciation reserve appropriate in this instance.

Q. WHY IS IT IMPORTANT FOR THE DEPRECIATION RESERVE TO CONFORM TO THE THEORETICAL RESERVE?

A. This is important because it sets the reserve at a level necessary to maintain intergenerational equity among Liberty Midstates' Iowa customers, as well as set the depreciation rates at the appropriate level based on current parameters and expectations.

Q. HOW WILL THE COMPANY IMPLEMENT THE REALLOCATION OF ITS DEPRECIATION RESERVE IF ITS PROPOSED RATES ARE APPROVED?

A. When the proposed depreciation rates are approved, the Company will reallocate the reserves on its books to match the allocation performed in the study.

E. Vintage Year Depreciation of General Plant Assets, FERC Accounts 391, 393-395, and 397-3995

Q. PLEASE DESCRIBE THE VINTAGE GROUP METHODOLOGY.

A. For general plant assets in accounts 391, 393-395, and 397-3995, Liberty Midstates proposes to implement a vintage year accounting method approved by the FERC in Accounting Release Number 15 ("AR-15"), *Vintage Year Accounting For General Plant Accounts*, dated January 1, 1997. AR-15 allowed utilities to use a simplified method of accounting for general plant assets,

excluding structures and improvements (referred to as "general plant"). The AR-15 release allowed high-volume, low-cost assets to be amortized over the associated useful life, eliminated the need to track individual assets, and allows a retirement to be booked at the end of the depreciable life. This method is often referred to as "amortization of general plant."

Adopting the method of accounting allowed in AR-15 changes the level of detail maintained in the asset records and performs the depreciation calculation at a vintage level rather than at a total account level. The plant asset balances will be maintained by vintage installed with the retirement being recorded when book depreciation has been completed. The empirical retirement data for actuarial or semi-actuarial analysis will no longer be reliable; however, the determination of useful life can be made appropriately with the use of market forces, manufacturer expected life, technological obsolescence, business planning, known causes of retirement, and changes in expected future utilization.

The depreciation calculation uses a useful life applied to a vintage versus the entire account. The depreciation recovery is complete when the vintage accumulated depreciation is equal to the vintage plant adjusted for estimated salvage and removal costs.

Q. PLEASE DESCRIBE THE METHODOLOGY OR TECHNIQUE EMPLOYED IN ANALYZING THE LIFE OF VINTAGE GROUP PROPERTY.

A. Actuarial life analysis was performed on each account. Those results and judgment formed the basis of the proposed lives for these accounts. The lives

being proposed reflect more recent experience and Liberty Midstates information and set an appropriate recovery period for the assets going forward.

Q. PLEASE DESCRIBE THE RESULTS OF THE VINTAGE GROUP ANALYSIS IN THE IOWA ASSET DEPRECIATION STUDY.

A. Liberty Midstates' present depreciation rates were compared to the Iowa Asset Depreciation Study recommendations in Appendix B of Watson Exhibit DAW-2. The rates proposed for Vintage Group property result in a decrease of $7,000.00 based on plant balances as of September 30, 2015. It should be noted that an additional $7,000.00 is needed to recover the difference between the allocated reserve and the theoretical reserve in this group. This computation is shown on Appendix A-2 of the Iowa Asset Depreciation Study attached as Watson Exhibit DAW-2.

III. THE SHARED SERVICES DEPRECIATION STUDY

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING DEPRECIATION RATES FOR LIBERTY MIDSTATES SHARED SERVICES ASSETS BASED ON THE RESULTS OF THE SHARED SERVICES DEPRECIATION STUDY.

A. The Shared Services Depreciation Study and analysis fully support Liberty Midstates' proposed depreciation rates applied to September 30, 2015 depreciable plant balances for General Property plant. The Shared Services Depreciation Study follows regulated industry's long-standing precedent for ALG straight-line depreciation. In this way, all customers are charged for their appropriate share of the capital expended for their benefit. In order to ensure intergenerational

equities, the Board should adopt the life characteristics and net salvage parameters proposed in this Study. The Shared Services Depreciation Study also incorporates updated service lives and reallocated depreciation reserves for Shared Services General Property assets in the proposed depreciation rates. Liberty Midstates' depreciation rates should be set at the levels supported in the Shared Services Depreciation Study in order to recover Liberty Midstates' total investment in property over the estimated remaining life of the assets.

Q. HOW IS THE SHARED SERVICES DEPRECIATION STUDY USED TO DETERMINE LIBERTY MIDSTATES' DEPRECIATION EXPENSE FOR THE TEST YEAR?

A. Liberty Midstates uses depreciation rates determined in the Shared Services Depreciation Study to calculate the appropriate depreciation expense going forward. The information presented in the Shared Services Depreciation Study is based on September 30, 2015 depreciable plant balances and all of the conclusions are based on those balances.

A. Summary of the Shared Services Depreciation Study

Q. PLEASE DESCRIBE THE SHARED SERVICES DEPRECIATION STUDY.

A. All Shared Services assets were acquired after Liberty Midstates' acquisition of the former Atmos Energy properties in Illinois, Iowa and Missouri in 2013. Because all assets were added after the acquisition, it was not possible to run a historic life analysis for Shared Services assets. The Shared Services Depreciation Study includes assets that are used as common property among Liberty Midstates' operating companies. I developed common life and net salvage parameters, and I

computed depreciation rates for each account within Shared Services. The Shared Services Depreciation Study is provided as Watson Exhibit DAW-3.

Q. WHAT DEPRECIATION RATES ARE YOU RECOMMENDING IN THIS PROCEEDING FOR THE SHARED SERVICES ASSETS?

A. My recommended depreciation rates for the Shared Services assets are set out in Appendix B of the Shared Services Depreciation Study attached as Watson Exhibit DAW-3. Based on updated service life and net salvage rates for Liberty Midstates' Shared Services depreciable plant in-service as of September 30, 2015, I derived the appropriate depreciation rates for General Plant. Below is a table summarizing the results.

TABLE 4

LIBERTY MIDSTATES SHARED SERVICES
COMPARISON OF CURRENT VS PROPOSED DEPRECIATION RATES
AS OF SEPTEMBER 30, 2015

Acct	Description	Plant at 9/30/15	Current Annual Expense	Proposed Annual Expense	Expense Change
3740	Land and Land Rights	157,767			
3900	General Structures & Improvement	6,571,914	328,596	164,633	(163,962)
3910	Office Furniture & Improvement	821,765	39,034	41,088	2,054
3921	Transportation Equip<12,000 LB	193,571	20,112	19,565	(547)
3940	Tools, Shop, and Garage Equipment	15,990	720	800	80
3980	Misc. Equipment	157,495	5,670	7,875	2,205
3990	OTH-Other Tangible Property	249,555	35,661	35,651	(11)
3991	Other Tangible Property - Servers H/W	30,326	5,756	6,065	309
3993	Other Tangible Property - Network H/W	348,710	66,185	49,816	(16,369)
3994	Other Tangible Property - PC Hardware	2,884,964	547,566	576,993	29,427
3995	Software 3 Yr Life	414,156	59,183	138,052	78,869
3995	Software 5 Yr Life	2,927,436	418,331	585,487	167,157
3995	Software 7 Yr Life	9,851,364	1,407,760	1,407,338	(422)
	Plus Amortization for Reserve Difference			0	0
	Total	24,625,013	2,934,573	3,033,362	98,789

Q. WHAT SHARED SERVICES ACCOUNTS SHOW THE LARGEST CHANGE IN DEPRECIATION EXPENSE BETWEEN THE CURRENT AND PROPOSED ACCRUAL RATES?

A. One account shows a large increase in depreciation expense: Account 3995 5 year life. The existing rates used a seven year life for this account. By stratifying the software into a 3, 5 or 7 year life, the consumption better aligns with the use of the assets. This change results in an increase of $167,156.00 in annual depreciation expense. Another account shows a large decrease in depreciation expense of $163,962.00: Account 3900 General Structures and Improvements. In this case the existing accrual rate was five percent and the proposed accrual rate incorporates 33 year life with zero net salvage. Proposed parameters for Share Services are shown in Appendix C of Watson Exhibit DAW-3. The Company does not know the origin of the existing accrual rate.

Q. WHEN DID LIBERTY MIDSTATES' SHARED SERVICES DEPRECIATION RATES LAST CHANGE?

A. The Company does not know when the Company's current depreciation rates were set or their underlying life and net salvage parameters. That information was not provided to Liberty Midstates when it acquired these assets. Liberty Midstates' regulatory personnel attempted to find this information, but it was not available.

Q. HOW DID YOUR STUDY ACCOUNT FOR THE FACT THAT YOU DO NOT KNOW HOW LIBERTY MIDSTATES CURRENT SHARED SERVICES DEPRECIATION RATES WERE DEVELOPED?

A. First, I determined the appropriate lives and net salvage based on the specific historical data and statistical analysis for Liberty Midstates property to incorporate the most current life expectations for the Company. Then, I applied those life and net salvage expectations in calculating depreciation rates for the Shared Services assets in order to accurately recommend new depreciation rates.

Finally, as it did with respect to its Iowa assets, Liberty Midstates proposes to implement Vintage Group Amortization for its Shared Services General Plant assets in FERC Accounts 391, 393-395, and 3970 to 3995. The change in depreciation expense in these accounts will come from updated life and net salvage estimates for certain accounts in that group.

B. Overview of Shared Services Depreciation Study Method

Q. PLEASE DESCRIBE YOUR SHARED SERVICES DEPRECIATION STUDY APPROACH.

A. I conducted the Shared Services Depreciation Study in four phases, as shown in Watson Exhibit DAW-3. The four phases are: Data Collection, Analysis, Evaluation, and Calculation. As part of the process for the study, I conferred with field personnel, engineers, and managers responsible for the installation, operation, and removal of the assets to gain their input into the operation, maintenance, and salvage of the assets. The information obtained from those individuals, combined with the study results was then evaluated to determine how the results of the historical asset activity analysis, in conjunction with Liberty

Midstates' expected future plans, should be applied. Using all of these resources, I then calculated the depreciation rate for each function. This is the same approach I utilized in conducting the Iowa Asset Depreciation Study.

Q. WHAT PROPERTY IS INCLUDED IN THE SHARED SERVICES DEPRECIATION STUDY?

A. There is one distinct class of property in this study: General Property. The General Property plant functional group contains facilities associated with the overall operation of the business such as buildings, office equipment and computers, software systems, network systems, transportation and power operated equipment. Shared Services assets include customer service and billing operations providing service to customers in Iowa, Illinois, and Missouri.

Q. WHAT DEPRECIATION METHODOLOGY DID YOU USE?

A. The ALG, straight-line, remaining-life depreciation system was employed to calculate annual and accrued depreciation in the studies for all plant except assets found in FERC Accounts 391, 393-395, 397-3995. The ALG methodology is widely used across the utility industry in the United States**.**

Q. WHAT DEPRECIATION METHODOLOGY DID YOU USE FOR PLANT ASSETS IN FERC ACCOUNTS 391, 393-395 AND 397-3995?

A. As is discussed later in this Direct Testimony, I propose to use the Vintage Group Methodology for these Shared Services asset accounts.

C. <u>Shared Services General Property</u>

1. Life of General Property Assets

Q. WHAT IS THE SIGNIFICANCE OF AN ASSET'S USEFUL LIFE IN YOUR SHARED SERVICES DEPRECIATION STUDY?

A. As it was in the Iowa Asset Depreciation Study, an asset's useful life in the context of the Shared Services Depreciation Study is used to determine the remaining life over which the remaining cost (original cost plus or minus net salvage, minus accumulated depreciation) can be allocated to normalize the asset's cost and spread it ratably over future periods.

Q. HOW DID YOU DETERMINE THE AVERAGE SERVICE LIVES FOR EACH ACCOUNT IN THE SHARED SERVICES DEPRECIATION STUDY?

B. I conferred with Company subject matter experts and used my professional judgment to establish a proposed average service life for each account. As detailed in the study, I relied on my judgment to incorporate any differences in the expected future life characteristics of the assets into the selection of lives. The objective of life selection is to estimate the future life characteristics of assets, not simply measure the historical life characteristics. More information can be found in the life analysis section of the Shared Services Depreciation Study, Watson Exhibit DAW-3.

Q. WHAT AVERAGE SERVICE LIVES FOR GENERAL PROPERTY ASSETS DO YOU RECOMMEND?

A. The results are shown in Appendix C of Watson Exhibit DAW-3 as well as in Table 5 below.

TABLE 5

LIBERTY MIDSTATES SHARED SERVICES
PROPOSED DEPRECIATION PARAMETERS
BY ACCOUNT AT SEPTEMBER 30, 2015

Acct	Description	Average Service Life	Iowa Curve
3900	Structures and Improvements	40	R2
3910	Office Furniture & Improvement	20	L2
3921	Transportation Equip<12,000 LB	10	SQ
3940	Tools, Shop, and Garage Equipment	20	SQ
3980	Misc. Equipment	20	SQ
3990	OTH-Other Tangible Property	7	SQ
3991	Other Tangible Property - Servers H/W	5	SQ
3993	Other Tangible Property - Network H/W	7	SQ
3994	Other Tangible Property - PC Hardware	5	SQ
3995	Other Tangible Property - Software 3 Yr Life	3	SQ
3995	Other Tangible Property - Software 5 Yr Life	5	SQ
3995	Other Tangible Property - Software 7 Yr Life	7	SQ

2. Net Salvage Rates - General Property

Q. HOW DID YOU DETERMINE THE NET SALVAGE RATES THAT YOU USED IN YOUR STUDY FOR SHARED SERVICES GENERAL PROPERTY?

B. Since there had been few, if any, retirements, I used judgment to establish the proposed net salvage parameters.

Q. WHAT ARE YOUR NET SALVAGE RECOMMENDATIONS FOR LIBERTY MIDSTATES' SHARED SERVICES GENERAL PROPERTY ASSETS?

A. My net salvage recommendations are found in Appendix C of Watson Exhibit DAW-3 and each account is discussed in the body of the Study. Table 6 below shows a summary of those recommendations by account.

TABLE 6

LIBERTY MIDSTATES SHARED SERVICES
PROPOSED NET SALVAGE PARAMETERS
BY ACCOUNT AT SEPTEMBER 30, 2015

Acct	Description	Net Salvage Percentage
3900	Structures and Improvements	0%
3910	Office Furniture & Improvement	0%
3921	Transportation Equip<12,000 LB	0%
3940	Tools, Shop, and Garage Equipment	0%
3980	Misc. Equipment	0%
3990	OTH-Other Tangible Property	0%
3991	Other Tangible Property - Servers H/W	0%
3993	Other Tangible Property - Network H/W	0%
3994	Other Tangible Property - PC Hardware	0%
3995	Other Tangible Property - Software 3 Yr Life	0%
3995	Other Tangible Property - Software 5 Yr Life	0%
3995	Other Tangible Property - Software 10 Yr Life	0%

D. Reserve Reallocation

Q. DID YOU PERFORM RESERVE REALLOCATION AS A PART OF YOUR SHARED SERVICES DEPRECIATION STUDY, AS YOU DID IN THE IOWA ASSET DEPRECIATION STUDY?

A. Yes, I did.

Q. IS THE SHARED SERVICES RESERVE ALLOCATION METHODOLOGY AND RATIONALE THE SAME AS THAT UTILIZED IN THE IOWA ASSET DEPRECIATION STUDY?

A. Yes, they are.

Q. WILL THE COMPANY IMPLEMENT THE REALLOCATION OF ITS SHARED SERVICES DEPRECIATION RESERVE IN THE SAME WAY THAT IT WILL IMPLEMENT ITS IOWA ASSET DEPRECIATION RESERVE?

A. Yes.

E. Vintage Year Depreciation of General Plant Assets, FERC Accounts 391, 393-395 and 397-3995

Q. ARE YOU PROPOSING THAT THE COMPANY UTILIZE THE SAME VINTAGE GROUP METHODOLOGY FOR SHARED SERVICES ASSETS IN FERC ACCOUNTS 391, 393-395 AND 397-3995 AS YOU PROPOSED FOR LIBERTY MIDSTATES' IOWA ASSETS IN THOSE FUNCTIONAL ACCOUNTS?

A. Yes, for the same reason that I proposed that methodology for the Iowa Assets in those functional accounts.

Q. DID YOU UTILIZE THE SAME METHODOLOGY OR TECHNIQUE IN ANALYZING THE LIFE OF VINTAGE SHARED SERVICES GROUP PROPERTY AS YOUDID FOR LIBERTY MIDSTATES' IOWA ASSETS?

A. Yes, I did.

Q. PLEASE DESCRIBE THE RESULTS OF THE VINTAGE GROUP SHARED SERVICES DEPRECIATION STUDY.

A. Liberty Midstates' present depreciation rates were compared to the Shared Services Depreciation Study recommendations in Appendix B of Watson Exhibit DAW-3. The rates proposed for Vintage Group property result in an increase of $263,299.00 based on plant balances as of September 30, 2015 when compared to the annual accrual using Liberty Midstates' present depreciation rates. The largest increases in this group come from Account 3995-Software 3 year life and 3995-5 year life, producing an increase of $78,869.00 and $167,157.00

respectively. The computations are shown in Appendix A-1 of Watson Exhibit DAW-3.

V. CONCLUSION

Q. Does this conclude your Direct Testimony?

A. Yes.

Filed with the Iowa Utilities Board on July 25, 2016, RPU-2016-0003

AFFIDAVIT

STATE OF TEXAS)
) ss:
COUNTY OF COLLIN)

I, Dane A. Watson, being first duly sworn on oath, do hereby depose and state:

1. I am a Partner of Alliance Consulting Group and my business address is1410 Avenue K, Suite 1105B, Plano, Texas 75074.

2. The foregoing written Direct Testimony and exhibits thereto were prepared by me or under my direct supervision and I have directed that my written Direct Testimony to be filed with the Iowa Utilities Board on July 25, 2016.

3. I hereby affirm that my written Direct Testimony is true and correct to the best of my knowledge and belief as of the date of this affidavit.

Done at Plano Texas, on July 22, 2016.

/s/ Dane A. Watson

Dane A. Watson, Partner

Subscribed and sworn to before me on July 22, 2016.

/s/ Mark Lites

Notary Public in and for said County and State of Texas
My commission expires July 1, 2019.